mikephippsfinance

Who's Been Sleeping In My Bed

Avoiding the Boom and Bust

Motels and management rights are pretty simple businesses in theory. Guests arrive, sleep, pay and leave. As a motelier or resident manager you are essentially selling sleep and in some cases relaxation. Provided the punters keep coming all is well. Yes, you might encounter competition and need to adjust tariffs and there are certainly highs and lows in many areas as far as occupancy goes but the business essentials remain the same. In my mind one of the greatest risks a buyer can face is knowing who is sleeping in the property, why they are there and whether they will be returning. Understanding the profile of the guests and what drives them to your business is at the heart of any well-judged purchase decision.

In the view of most valuers and seasoned operators, a wide variety of guests and a wide variety of demand drivers is key to essentially de-risking your business and ensuring that bookings do not suddenly dry up. Having a significant proportion of your occupancy being driven by one or two demand drivers is not always bad but certainly needs to be understood. The classic example is the regional motel running 95% occupancies at tariffs twice the regional average. Sounds fabulous but of course there is always a catch. Most motels reflecting these operating dynamics are enjoying strong demand because of something specific that is happening in the area. It could be an infrastructure project, a resource sector expansion and a special event. The trick is to understand the likely life of the project that is driving demand and the lay of land once the project is complete. In the case of south east Queensland located serviced apartment type management rights and motels we will see a significant lift in revenues during the G20 summit in Brisbane. For buyers looking at properties that have enjoyed this increase in income the obvious question is "Will the G20 be repeated every year in Brisbane?". If the answer is no then the buyer needs to contemplate the sustainable revenues year in, year out in the absence of a substitute major event. Conversely, if you are buying a motel in Toowomba, Tamworth or Bathurst there's a strong chance the carnival of flowers, music festival and car race respectively will continue into the future so peak revenues for those events would be considered sustainable over the loan term.

During the mining boom (is it still going I wonder?) some regional towns had the good fortune to enjoy substantial increases in motel and serviced apartment room demand as mining companies struggled to find accommodation for staff. Occupancies and tariffs went through the roof and many a canny operator put their business on the market with their much improved trading numbers underpinning the price. Trouble is, all that improved trade is concentrated on one demand driver. You buy a motel running 90% occupancy at record tariffs driven by a single economic trend that's demand concentration risk personified. When or if the miners leave town (or build their own workers accommodation) or slow down (and they have) what's Plan B? You are back to 50% occupancy at $95 a night and if you borrowed money you are under the pump. The value of your asset has most likely declined significantly and your 50% geared loan is now notionally geared way higher on your current value. With any luck your rent will have been set before the boom and maybe you can survive. The sad reality is that some operators simply don't get through. That's a shame because these are incredible businesses with some of the best return on equity numbers I have seen. Just make sure you are not buying on a single unsustainable demand driver or trend and have a Plan B.

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